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June 18, 1997

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COMMISSION
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Mr. Mark Nadel
Universal Service Branch
Federal Communications Commission
2100 M Street
Washington, D.C. 20554

Re: Auction Proposal for Universal Service

Dear Mr. Nadel,

Attached, per our discussions of June 17, 1997, is a copy of GTE's Auction Proposal for Universal Service provided to the California Public Utilities Commission on May 8, 1997. Please call me on 463-5293 if you have any questions or need additional information.

Sincerely,

W. Scott Randolph
Director - Regulatory Matters

Attachment

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Auction Proposal for Universal Service GTE


May 8, 1997

Why an Auction?



- **Market solution for setting support levels**
 - » **Replaces Cost of Service Regulation**
 - » **Bids reflect bidders' own cost expectations**
 - » **Bids also reflect any follow-on revenues**
- **Helps to ensure adequacy of support**
 - » **Firms, not commission, specify support amount**

Why an Auction? 2

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- Promotes efficient supply
 - » Identifies low cost suppliers
 - Helps minimize need for support
 - Mechanism for correcting errors in initial support levels
 - Adjusts to changes over time
 - » Technology, input prices, definition of universal service



Background and Prerequisites

Context for the Auction



Commission must define item to be auctioned

» **COLR obligation in a CBG**

■ **Winner must be allowed to win**

» **CLEC winning auction acquires obligation**

■ **Loser must be allowed to lose**

» **Losing ILEC must lose obligations and support**

– ***Includes resale and unbundling obligations***

» **Allows for exit**

Context for the Auction, 2

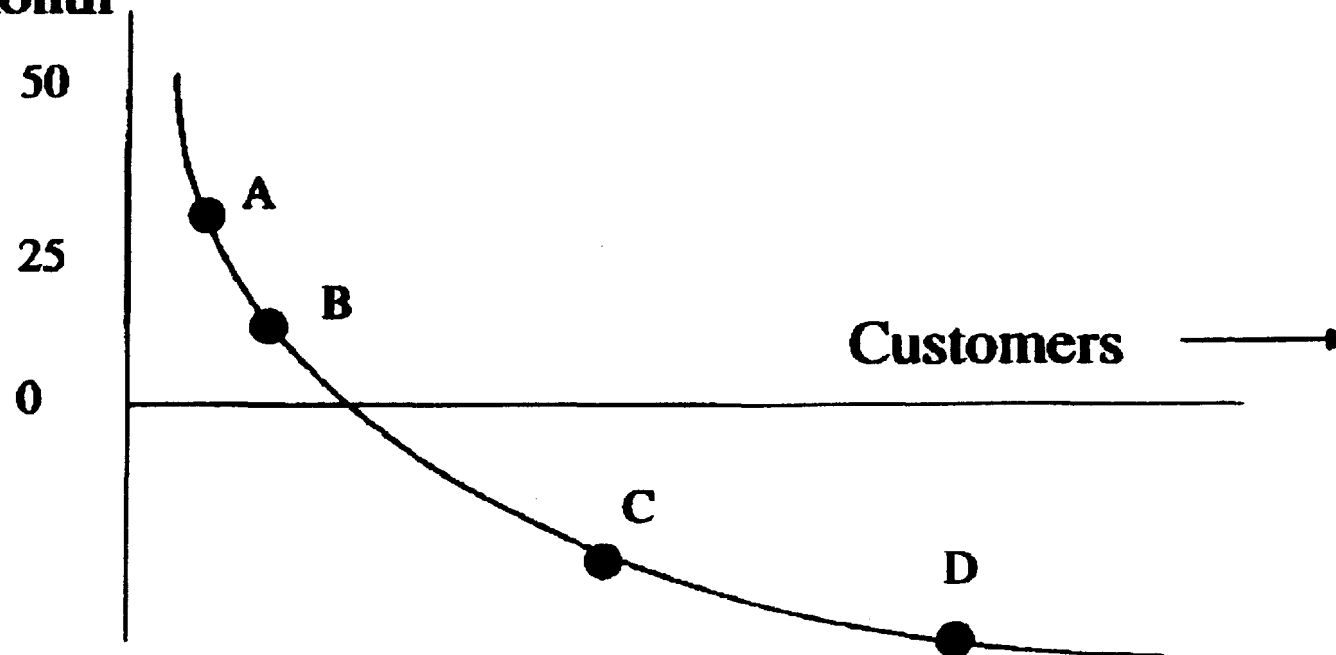
- For competitive neutrality, each COLR in a CBG must have
 - » Same obligation
 - » Same support
- CPUC has already adopted COLR obligation as requirement for CHCF-B support
 - » GTE proposes the following amendment:
 - COLR must offer CPUC-defined service package subject to CPUC-established price ceiling

Ordering of Customers within a Service Area, By Support Need

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■ Support Needed,
\$/month



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Initial Support Levels



- Based on support currently determined by the CHCF-B
- One time adjustment process
 - » ILEC can rearrange support across CBGs
 - » Total support received is the same.
 - Analogous to PCI constraint in price caps
 - » Adjustment can be made only once
 - » Adjustment helps to mitigate any errors in cost-based support

Auction Elements



- Certification of Qualified Bidders
- Determination of Areas to be Auctioned
- Auction Rules
- Post-Auction Implementation

Certification of Qualified Bidders



- Carrier must be an Eligible Telecommunications Carrier (“Eltel”)
- Must be willing to undertake COLR obligation specified by CPUC
- CPUC may wish to verify bidder’s capability to perform as COLR

Auction Design Objectives

Objectives considered in optimization:

- **Promote competition “in the market” where feasible:**
 - » Ex post competition among COLRs
- **Promote efficient supply**
 - » By choosing most efficient firms
- **Keep support as low as possible**
 - » Competition “for the market”
 - » To minimize deadweight losses



Nominations, ILEC Exit and Bidding

Nomination of CBGs for Bidding

- Twice yearly window for Qualified Bidders (“QBs”) to nominate areas
 - » Each QB may nominate any number of CBGs
 - » QB deposits \$1000 per nominated CBG, refundable if the QB submits a valid bid
- Nominations not accepted for CBGs auctioned within last three years
 - » If auction changed number or identity of COLRs
- The sole COLR in a CBG may not nominate the CBG, except by applying to exit (see next slide).


ILEC Exit

- After nominations are closed and announced, a sole COLR may apply to exit.
- If the sole COLR applies to exit, the CPUC asks if any other eltel is willing to become COLR at current support level.
 - » If more than one eltel volunteers, all enter an auction with the current COLR excluded and reserve equal to the current support level
 - » If one eltel volunteers, then
 - that eltel becomes COLR at current support level
 - ILEC receives no support and loses COLR obligations
 - » If no takers, CBG is deemed nominated for auction

CPUC Tasks

- CPUC may nominate some CBGs on its own motion in limited circumstances
 - » Initially, in areas where multiple COLRs already receive support
 - » At any time, for unserved areas
- CPUC publishes list of CBGs and firms who nominated them
 - » Announces reserve support level for each CBG
 - Reserve is a multiple of the current support level
 - » Opens window for firms to register for bidding

The Bidding Process

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- Single round, sealed-bid auction
 - » Less vulnerable to collusion
 - » Simpler for administrators and for bidders
 - Separate bids for each CBG
 - Form of bid is per-customer support amount

Determination of Winners

- **The lowest bid and sufficiently close other bidders are declared COLRs**
 - » 1) All bidders whose bids do not exceed the lowest bid by more than 15% of the sum of that bid and the basic service price will be declared COLRs.
 - » 2) If no competing bid is within the range described in 1), but at least one bid is within 25% of the sum of the lowest bid and the basic service price, then the two lowest bidders will be declared COLRs.
 - » 3) Otherwise, only the lowest bidder will be declared a COLR.
- **The Commission can vary the tradeoffs among objectives by varying the parameters in this description.**

Determination of Support Amount



- **All firms whose bids are accepted receive same support per customer**
 - » Achieves competitive neutrality among COLRs “in the market”
- **Support is at level of highest accepted bid**
 - » Ensures that support is sufficient
 - No carrier has to serve at less than its bid
 - » Outcome similar to competitive market
 - “price” is set by a marginal firm
 - » Does not affect expected value of support
 - Bidders adjust their bids according to payment rule

Bid Withdrawal Rules

- Once auction results are announced, bidders are given an option to withdraw
 - » Lowest bidder gets first option, others in sequence
 - » Support is recomputed as though withdrawn bids had not been made
 - » Withdrawal cannot leave CBG without a COLR

Exceptions



- If there are no qualified bids or if the ILEC is the sole bidder, then the ILEC continues as COLR and receives
 - » the original support level, if it did not apply to exit
 - » the reserve price, if it did apply to exit

Post-Auction Implementation



■ Assumption of COLR obligations

- » If no change of COLRs, new support applies 10 days after close of auction
- » If there is a change of COLR, new support applies 10 days after date of change
- » If COLR is newly designated, then maximum transition period is:
 - 90 days if ILEC is also COLR
 - One year if ILEC is not COLR

■ Terms of COLR Obligation

- » If auction results in change in the number and identity of COLRs, no new nominations accepted for 3 years
- » If auction does not change identity or number of COLRs, area can be nominated at next 6 month window

Changes to COLR Obligation

■ Commission may review and modify COLR obligation, including basic service definition

- Subsequent auctions will be based on COLR obligation posted at time of nomination
- Existing COLR obligation is not affected until area is rebid
- Reserve should reflect modified obligation


Transfer of COLR Obligation

- Any COLR may transfer or sell its obligation to any other QB at any time
- But transfer cannot reduce the number of COLRs in a CBG

Auction Design to Accommodate Synergies

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- GTE's proposed auction design makes some provision for synergies:
 - » Bids within a given range accepted
 - » Option to withdraw
 - » Ability to transfer COLR obligations after auction
 - More complex design could more fully account for synergies

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